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BOOK REVIEW

Monetary Institutions in an Evolving World

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LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY. By Rosa M. Lastra. *Oxford University Press*, 2006. Pp. vii, 547. $ 175.00 (hardcover).

INTRODUCTION

Since the beginning of the twenty-first century, too many people have the impression that global governance is impossible. They think that anonymous market forces move throughout the world like swift and invincible Behemoths compared to nation-states—poor little Leviathans—who flounder along old-fashioned geographical frontiers as clumsy and isolated dwarfs. The 1997 Asian financial and monetary crisis provided a certain confirmation of the insufficiency of international regulation. Judicial victories of "vulture funds" ("sovereign pirates")[1] have seemed to

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1. ROSA M. LASTRA, LEGAL FOUNDATIONS OF INTERNATIONAL MONETARY STABILITY 477-78 (2006). Lastra provides a clear description and analysis of the judicial victory of the 'Elliot' private fund against the Peru Brady Plan. Their victory was based on a 'Blitzkrieg' strategy. *Id.* The Elliot fund froze Peruvian accounts by way of a summary procedure before the Brussels Court of Appeal in 2000. Brussels was an appropriate venue because the accounts were under the

many to be more blows against the hope of an orderly globalization.

Rosa Lastra's book provides another point of view, anchored in an international society that has been in the making since the Bretton Woods Conference of July 1944. In this view, a new world, a more global and yet orderly world, is slowly taking shape under our eyes, thanks to relatively silent but effective monetary institutions and monetary arrangements. No doubt we are far from the achievement of such a new world. After more than 50 years of unceasing effort, the construct of an international legal environment favoring monetary stability is still at the foundational stage. What about the next 50 years? One thing is for sure: the *End of History*[2] is not for tomorrow. Nobody knows what the world will be tomorrow, but it seems to be full of promises. Still, we must pray that today's "foundations" of a stable global monetary regime do not come to appear like the foundations of the gigantic cathedral in Pisa, Italy, where the pillars are marked on the ground but the cathedral was never built due to wars, famine, and the Black Death. Only the transept was finished; it is nevertheless a marvelous building next to the leaning Tower of Pisa. The way our monetary environment has evolved suggests that the necessary structure for a stable monetary world will be within the sight of the next generations. Lastra focuses on this evolution and writes

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control of Euroclear Bank, in its capacity as operator of the Euroclear System. *See id.* Since then, in another case, the same Court of Appeal has reversed its position. It has refused to freeze accounts of the state of Nicaragua in the Euroclear System for payment to be made to holders of Nicaraguan "*Bonos de Pago por Indemnizacion.*" *See* Republic of Nicaragua v. LNC Investments and Euroclear Bank S.A., General Docket No. 2003/KR1334 (Ct. App. Brussels, 9th Chamber, Mar. 19, 2004); *see also* Georges Affaki & Jean Stouffiet, *Chronique de droit bancaire international* [Chronicle of International Banking Right], 101 BANQUE ET DROIT 82-90 (2005) (Fr.); Lee C. Buccheit & Jeremiah S. Pam, *The Hunt for* Pari Passu, INT'L FIN. L. REV., Feb. 2004, at 20. A Supreme Court appeal against that last decision has been rejected. Republic of Nicaragua v. LNC Investments and Euroclear Bank S.A., Cass. 23 Dec. 2005, *Arr. Cass.* (unpublished). After these cases, Belgian law has been modified to prohibit such freezing of assets in the hands of a clearing and settlement institution. Belgian Law of Apr. 28, 1999 (revised Nov. 19, 2004), http://www.cass.be/loi/loi2.htm (on settlement finality in payment and securities settlement systems).

2. *See* Francis Fukuyama, The End of History and the Last Man (1992); *cf.* David A. Westbrook, City of Gold: An Apology for Capitalism in a Time of Discontent (2004) (advocating in favor of a critical acceptance of our time as a time for global capitalism).

about what has been experienced in our recent past, what is presently in place, and what is still under construction.

Lastra's book offers a unique, extremely clear, documented, and concise description of the legal foundations of international monetary stability. Charles Goodhart writes in his foreword that Lastra's book is "a major work of serious scholarship. If anyone wants to know how the legal structures of the world's various overlapping monetary systems are set up (and how and why) in the first decade of the twenty-first century, this book is the place to turn."[3] Geoffrey Miller adds yet in another foreword that "[i]t is destined to be an essential reference for lawmakers, central bankers, bank regulators, and legal and policy planning staff in internationally active financial institutions."[4]

Legal Foundations of International Monetary Stability is divided into three parts devoted to the analysis and critical description of the foundations of monetary stability at (1) the national level (monetary sovereignty, central banking, banking supervision, management of banking crisis, emerging economies); (2) the European Community[5] level (history of the monetary integration, European web of monetary institutions, European banking supervision and crisis management); and (3) the international level (before and after Bretton Woods, the evolving role of the IMF, the present and future international financial architecture).

A French literary critic, Maurice Blanchot, writes that in every successful book there is a convergence point around

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3. LASTRA, *supra* note 1, at ix.

4. *Id.* at xii.

5. Lastra notes that the terms *European Union* (EU) and *European Community* (EC) are sometimes used indistinctly. 'European Union' was coined by the Maastricht Treaty (1992). *See* LASTRA, *supra* note 1, at 174 n.2. It added to the existing common policies (mainly economic) an intergovernmental cooperation in the field of security, justice and home affairs. *See id.* In the same treaty, it has been decided that the terms 'European Community' had to replace the terms 'European Economic Community.' *See id.* It is perhaps but a detail, but it is rare to find the explanation. The European Constitution "signed in Rome on 29 October 2004 was thrown into a legal limbo following the negative results of the referenda in France and the Netherlands in 2005." *Id.* at xv. Lastra still refers to that draft text insofar as it shows the direction into which the European initiative intended to go, even though it does not provide for fundamental reforms for European monetary issues.

which the book flourishes.[6] In the case of Lastra's book, this point is in Chapter 13 relating to the law of the International Monetary Fund (IMF) (371-445), in which she describes and comments on the IMF functions (e.g., surveillance, financial assistance, and technical assistance). Her descriptions and comments are rooted in her experience and her conviction of the usefulness of this institution which, after each international monetary or financial crisis, is the subject of intense criticism, yet it rises again from the ashes like the phoenix.

Lastra worked at the Legal Department of the International Monetary Fund in Washington D.C. in the nineties.[7] She saw the break-up of the Soviet Union in December 1991, as well as the tentative strategy to create the foundations for a Russian ruble financial market (not to mention the creation of as many new currencies as there were new independent states).[8] In 1992, she saw the signing of the Maastricht Treaty regarding the European Union which, on the existing foundations of the European "common market," laid down the foundations for a monetary union. Thus, she has been at the forefront of the most major developments in the field of monetary law and practice in the last decade of the twentieth century.

The book provides a brilliant description and analysis of the national and international monetary stability dilemma, with, as it is inevitable in the current context, a propensity to recoup it with the broader problematics of financial stability.

I will only focus on those aspects of the book that relate to the interconnections between monetary policy and

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6. Maurice Blanchot, L'Espace littéraire (1955).

7. LASTRA, *supra* note 1, at xiii. Rosa Lastra is Senior Lecturer in International Financial and Monetary Law, Centre for Commercial Law Studies, Queen Mary, University of London. *See generally* LASTRA, *supra* note 1. She is a founding member of the European Shadow Financial Regulatory Committee, an associate member of the Financial Markets Group of the London School of Economics, an affiliated scholar of the Center for the Study of Central Banking at New York University Law School and an observer at the Monetary Committee of the International Law Association. *See id.* She has been a consultant for the IMF, the World Bank, the Federal Reserve Bank of New York, the Asian Development Bank, and the UK Treasury select committee. *See id.*

8. *See* LASTRA, *supra* note 1, at 22.

prudential supervision. Many sensitive financial and monetary issues which are masterly dealt with in the book[9] will not be reviewed, even though they contribute to making this book a great introduction, in fact far more than an introduction, to one of the most striking successes of our (peacefully) globalizing post-WWII society.

I. MONETARY SOVEREIGNTY AND ITS NATIONAL AND INTERNATIONAL SURRENDER

Sovereignty is the power to impose will, or, to speak in legal terms, to impose law, to decide on content. If you have the ability to impose your law on subordinates, it means that you are their sovereign. If in commending subordinates you must comply with certain rules which are beyond your control, you are not their sovereign. There is probably someone above you who exercises sovereign power—who decides what the law will be. In a market economy, a fortiori in a globalized market economy, sovereignty is an eroded concept. It is not so much that there is someone above any sovereign, but that there are forces and laws of the market which are recognized—up to a certain extent—as sovereign. Our sovereigns (nation states) take the market phenomenon as a matter of fact, an undisputable reality. A critical resistance to the idea of market sovereignty is necessary because markets are not perfect. Nevertheless, market forces are legitimated—in a materialist context—by the prosperity they generate. It is as if God, once exclusive beneficiary of popular reverence, had finally found a rival: the invisible hand of the market.[10]

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9. For example, what is a systemic risk? *Id.* at 138-50; How to deal internationally with a bank insolvency. *Id.* at 145 n.120 (Herstat cases); *id.* at 68 n.85 (BCCI); *id.* at 128-37 (Banco Ambrosiano, Franklin National Bank); How did the European Monetary Union develop? *Id.* at 173-206; How does the 'prohibition of excessive deficits' within the Euro zone work? *Id.* at 254-58, 265-70; How does the IMF contribute to global financial stability not only by way of financial assistance, but also by way of surveillance? *Id.* at 398-441, 474-95.

10. At the Age of Enlightenment, the sublime idea appeared that man could develop autonomy—empowerment—notably thanks to education. *See* MARIE JEAN ANTOINE NICOLAS DE CARITAT MARQUIS DE CONDORCET, ESQUISSE D'UN TABLEAU HISTORIQUE DES PROGRÈS DE L'ESPRIT HUMAIN [Outlines of a Historical Table of Progress of the Human Spirit] (1822). As a consequence of that autonomy, God has been dethroned. But after two centuries of hesitation, market forces (governed by the rules of 'freedom,' 'equality,' and 'calculativeness') seem to occupy the terrible throne left free by God. The

Lastra rapidly recalls the history of the concept of sovereignty from the French historian Jean Bodin (the sovereignty of the Monarch) to the French philosopher Alexis de Tocqueville (the sovereignty of the people) and passing by Hobbes (Leviathan), Machiavelli (The Prince), and the Founding Fathers (the sovereign has to ensure public peace). She does not tackle contemporaneous hesitations about the concept of sovereignty. Yet, contemporaneous debates about sovereignty have produced significant new lights. One of the most striking developments is offered by German lawyer and fascist Carl Schmitt (1888-1985), former student of sociologist Max Weber, who identifies sovereignty as well as the sovereign is capable of decisive action without other limits like that of his own will—especially in crisis situations, i.e. in a "state of exception."[11] He powerfully argued against the liberal idea of 'sovereignty of the people' which would be either an illusion or a deception. Sovereignty is closely linked with force and in crisis times, with violence. In that direction, Tullio Treves considers that "State 'sovereignty' belongs to the area of fact and not to the area of law... Sovereignty is seen as a factual situation from whose existence international law draws consequences."[12]

Lastra recalls the 1929 case before the Permanent Court of International Justice relating to the "Brazilian and Serbian loans" according to which "it is a generally accepted principle that a State is entitled to regulate its own currency."[13] This principle has been significantly eroded, not so much by market forces than by the development of international law. Nowadays, it is generally accepted that monetary regulation is "a matter of international

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horizon of 'fraternity' which was the main source of enthusiasm for the French Enlightenment has vanished and is no more taken *au sérieux*. Today, fraternity seems to be reduced to a source of aesthetical satisfaction (about 'solidarity' and 'sympathy,' see WESTBROOK, *supra* note 2 at 300-01). The ideal of autonomy has been somewhat tarnished by this mercantile horizon. On 'calculativeness,' see Oliver E. Williamson, *Calculativeness, Trust, and Economic Organization*, 36 J. L. & ECON. 453 (1993).

11. CARL SCHMITT, POLITICAL THEOLOGY: FOUR CHAPTERS ON THE CONCEPT OF SOVEREIGNTY (George D. Schwab trans., 2006). Carl Schmitt was a fierce supporter of Adolf Hitler in the 1930s.

12. LASTRA, *supra* note 1, at 17 n.43.

13. LASTRA, *supra* note 1, at 16 n.41.

interest."[14]

With a surprising reference to emotions, Lastra states that "not a tear should be shed about the decline of monetary sovereignty."[15] If we want to live in a somewhat stable international environment, there is no doubt that the nationalistic principle of the "Brazilian and Serbian loans" case cannot be considered a correct ruling.

The decline of monetary sovereignty is two-fold. On the one hand, independence of central banks (see below) constitutes an auto-limitation of the state. Like Ulysses[16] asking his crew to tie him up to the mast to pass by the sirens' isle,[17] a government surrenders monetary policy to the central bank.[18] On the other hand, international arrangements at the European level (the building of the European Monetary Union since 1993, and its accomplishment between 12 countries since 1999 – 13 countries since 2007) and the international level (the IMF Articles of Agreement) constitute a voluntary surrender by nations of their monetary sovereignty. These structural arrangements allow nations to better face the considerable power of markets. Especially in countries where cross-

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14. DOMINIQUE CARREAU & PATRICK JUILLARD, DROIT INTERNATIONAL ÉCONOMIQUE [Economic International Law] 551 (1998); *see also* Norwegian Loans (Fr. v. Nor.), 1957 I.C.J. 9, 37 (July 6) (in which the International Court of Justice stated that "[t]he question of conformity of national legislation with international law is a matter of international law"). Rosa Lastra adequately places in its context this famous case about the question of the international validity of the "gold clause." *See* LASTRA, *supra* note 1, at 25 n.80. Economic International Law.

15. LASTRA, *supra* note 1, at 27.

16. *See* HOMER, THE ODYSSEY, Book XII. (George Palmer trans., The Riverside Press 1884) (c.900 B.C.).

17. About the idea that constraints may serve freedom in case of limited rationality of the agent, see JON ELSTER, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY (1979); Rosa Lastra—referring to JAMES M. BUCHANAN, THE LIMITS OF LIBERTY: BETWEEN ANARCHY AND LEVIATHAN 93 (1975)—uses the image of Robinson Crusoe and concludes that "a government, recognizing its own weakness in the face of temptation, limits itself by allowing or creating autonomous or independent bodies." LASTRA, *supra* note 1, at 63.

18. This does not mean that a state where monetary policy has been entrusted to an independent central bank no longer has monetary sovereignty, but that such sovereignty is no longer exercised by a political power. As pointed out by Lastra, this is comparable to the independency of the judiciary. LASTRA, *supra* note 1, at 64.

border capital flows have been liberalized.[19]

Monetary sovereignty includes (1) the power to issue coins and notes (*ius cudendae monetae*); (2) the power to regulate the use of money and, Lastra adds,[20] to regulate the banking system; (3) the power to control the money supply and the interest rates (monetary policy); (4) the power to control the exchange rate (exchange rate policy); and (5) the power to impose exchange and capital controls.

The first power (*ius cudendae monetary*) is one of the most visible symbols of sovereignty.[21] The second power is the classical power to legislate. The third and fourth powers are not really sovereign since they are confronted by market powers in an open economy.[22] The fifth monetary power is the only one which allows a state to escape from the attraction of market forces. The legitimacy of the use of this last power is, of course, very sensitive.[23]

Central bank independence has generated many studies and papers. Independence is considered a necessity to avoid monetary manipulations for electoral purposes[24] as

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19. *See* Treaty Establishing the European Community, Dec. 24, 2002, O.J. c 325, *available at* http://eur-lex.europa.eu/en/treaties/dat/12002E/pdf/12002E_EN.pdf [hereinafter EC Treaty]. Article 56 of the EC Treaty has obliged Members States to liberalize capital movements not only between Members States, but also between Members States and third countries. *Id.* at 24.

20. LASTRA, *supra* note 1, at 22. She rightly limits the monetary issue at stake to the regulation of credit. Indeed, prudential regulation of bank activity is not *per se* a monetary issue, even though it is manifestly an issue for the financial stability problematic.

21. In the synoptic gospels, the demonstration of the distinction to be made between the sovereignty of God (on souls) and the sovereignty of Cesar (e.g., on tax matters) is made on the basis of a coin: "Jesus . . . said, ' . . . Show me the coin used for paying the tax.' They brought him a denarius, and he asked them, 'Whose portrait is this?' . . . 'Caesar's,' they replied. Then he said to them, 'Give to Caesar what is Caesar's, and to God what is God's.'" *Matthew* 22:18-21.

22. Generally, the central bank manages monetary policy issues, while exchange rate policy remains in the hands of the government. *See* LASTRA, *supra* note 1, at 57.

23. *See* LASTRA, *supra* note 1, at 23 n.70. Rosa Lastra observes that for the time being, and especially in the aftermath of the Asian crisis, there is a "lack of consensus in the academic literature about the wisdom of capital flows . . . and the inconclusive evidence." *Id.* at 398.

24. Devaluation dopes exportation and employment and may artificially create a sentiment of euphoria. *See* LASTRA, *supra* note 1, at 45.

well as to neutralize the abuse of seigniorage.[25] Lastra brilliantly outlines the current state of academic debates and proposes her personal point of view on the subject: "As a practical matter, politics has to play a role in the activities of central banks: the goal of complete insulation from politics cannot be realized."[26] She usefully describes the case of the Bundesbank (originally West Germany's central bank), whose independence and respectability has been a model for the European Community. During the German reunification (3 October 1990), there was a fierce opposition between the government of West Germany and the Bundesbank about the rate of exchange for the East marks against the D-marks. Chancellor Kohl decided for a parity of one to one. The political decision has been considered symbolic of the reunification. The question of price stability was set aside. To combat the inflationary situation generated by this decision and the "government's failure to articulate an appropriate fiscal policy,"[27] the Bundesbank was obliged to have a high interest rate policy in 1992-1993.

Lastra points out that the Bank of England enjoys a unique situation. Since it is under the Bank of England Act 1998, the monetary objective (inflation target) to be pursued by the Monetary Policy Committee is specified by

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25. Seigniorage is the sovereign power to issue additional money without justification beyond the sovereign will. It is seen as a kind of tax against holders of money, since the burden of the additional amount of issued money will be shared by these people under the form of inflation (loss of value of the currency). Inflationary finance will generate distrust in the currency even though, temporarily, it allows the state to avoid the unpopular measure of being obliged to levy new taxes to meet its own obligations. *See* LASTRA, *supra* note 1, at 54-55.

26. *Id.* at 53. It is to be noted that central bank independence is considered required only vis-à-vis the political power. Independence vis-à-vis the market participants is not a point of concern for central banks, notably because the central bank is the bankers' bank. For the prudential supervisor, which has only an administrative relation with banks, the independence vis-à-vis market participants that are subjects of prudential control is of course a central issue (as identified notably by the theory of the 'capture'). *See* LASTRA, *supra* note 1, at 101; *see also* MARC QUINTYN, SILVIA RAMIREZ & MICHAEL W. TAYLOR, THE FEAR OF FREEDOM: POLITICIANS AND THE INDEPENDENCE AND ACCOUNTABILITY OF FINANCIAL SECTOR SUPERVISORS (IMF Working Paper WP/07/25, Feb. 2007). The risk of capture is one of the reasons why in jurisdictions with a poor experience of prudential control the empowerment of the central bank is generally the most efficient solution. *See* LASTRA, *supra* note 1, at 91.

27. LASTRA, *supra* note 1, at 60.

the Chancellor of the Exchequer.[28]

II. CENTRAL BANK ACCOUNTABILITY AND TRANSPARENCY

An independent central bank must answer to the question of democratic legitimacy. The central bank is an institution within the structure of democratic politics. In some contrast to the judiciary, a central bank may be "independent," but nonetheless requires political, in the narrow sense, legitimacy.[29] Such legitimacy comes from accountability and transparency in the implementation of monetary policy. Accountability and transparency supplement—and do not replace—trust in the institution.

Accountability can be defined as the obligation to give account and to justify action. To be effective, accountability should be related to criteria which set forth the objectives that the institution must pursue, and for which it must regularly give account. The most striking example of a list of criteria in the sector of financial supervision is offered by the Financial Services Authority (FSA) in the U.K.[30] Narrowly defined objectives exemplified by the European Central Bank (price stability[31])—compared to the broadly defined and multi-faceted objectives of the U.S. Federal Reserve (stable prices, growth, and employment)—clarify the role of the independent institution but could limit its room for action and, consequently, its performance.

Seen procedurally, accountability is a matter of periodic reporting (e.g.: annual report, public hearings), and openness to public scrutiny. Accountability may also be seen from an accounting perspective, as literally giving

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28. *See id.* at 71.

29. On the level of the European Union, the OLAF (European Anti-Fraud Office) case has "clarified the legal position of the European Central Bank. '[T]he ECB, pursuant to the EC Treaty, falls squarely within the Community framework" even though it is not included in the EU's main institutional framework. LASTRA, *supra* note 1, at 223. As commented by Rosa Lastra, "[t]he ECB is . . . a 'special' EU institution . . . 'somehow outside' the core EU institutional framework." *Id.* The ECB is independent "within the Community structure" (not independent from the Community). *Id.* at 225.

30. *See id.* at 330. For a recent 'mapping' of independence and accountability in a set of 32 countries, see QUINTYN, RAMIREZ & TAYLOR, *supra* note 26.

31. *See* LASTRA, *supra* note 1, at 215.

account of one's performance.[32] Such accountability claims to be more technical than political, and more market-based than based on democratic processes. Even though it may be decisively interesting to know the 'performance' of a public institution (to conduct a "cost-benefit" analysis), there are significant dangers in concentrating on such an approach.[33]

Accountability is closely linked to transparency. Transparency should be an essential feature of governance in a market economy but transparency is always limited.[34] Nothing in our acts can be perfectly transparent (only a vacuum is perfectly transparent). 'Transparency' refers to clarity in the action, disclosure, and effort to educate the public for the understanding of the actions of the person who claims to be transparent.

Accountability and transparency generate significant costs and mobilize precious forces within the institution. The balance between silence (essential to ensure efficiency of certain kind of actions—for example the rescue of a weakened credit institution or the preparation of a monetary devaluation) and speech (too often used for ideological[35] purposes rather than to give account) is delicate. Effective accountability and transparency are not matters of mechanical transfer of information. They need reciprocal confidence and above all, communication with 'variable geometry.' The criterion of such geometry is the subsistence of adequate public confidence and the prevention of expectation gaps by differing communications of information which could influence market stability. The Long-Term Capital Management (LTCM) rescue is a striking example of a relatively silent resolution of a possible systemic disruption of financial markets.[36]

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32. *See id.* at 70.

33. In essence, a public institution acts in the sphere of public goods. Providing public institutions performance figures is a highly difficult exercise subject to multiple and unavoidable manipulations. This demarcates the 'Anglo-Saxon' model that is rooted in figures (more objective and transparent) from the German/Japanese model that is rooted in personal relations (more subjective and opaque).

34. *See* LASTRA, *supra* note 1, at 72-73.

35. On ideology, see *infra* note 51.

36. All information on the rescue has been provided *post facto*. For an account of the LTCM rescue by the injection of $3.625 billion in a couple of days by the persuasive action of the Federal Reserve Bank of New York against 14

III. CENTRAL BANK, BANKING, AND FINANCIAL SUPERVISION

The debate about whether banking supervision should be located inside or outside the central bank is far from being purely academic. In Europe, the legal framework and the institutional infrastructure are moving quickly. The creation of the European Central Bank (ECB) on the one hand, the will of the European Commission to achieve an effective internal market for financial services[37] on the other hand, and the integration of the Eastern countries on top of that, call for an urgent reconsideration of this debate.[38]

Bank activity and the management of monetary policies are closely linked. First, banks create money. When a bank provides a loan to a client, most of the time, the bank does not deliver bank notes to its client. The bank writes the amount lent on his current account and the client uses the amount credited to make payments via wire transfers.

In order to conduct monetary policy, central banks are interested in knowing how much money is generated outside the issued paper money (fiduciary money) for monetary policy purposes. Second, the interest rate paid on a banking loan is, to a certain extent, linked to the interest rate fixed by the central bank for refinancing operations (the central bank as bank of banks). Third, in case of a crisis, a bank which faces temporary liquidity difficulties might be rescued by its central bank, acting as lender of last resort (LOLR).

Banking supervisors have another role to play: prudential regulation of the bank activity. Their acts and the focus of their attention are significantly different. In the

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major banks involved in that accident, see, e.g., ROGER LOWENSTEIN, WHEN GENIUS FAILED: THE RISE AND FALL OF LONG-TERM CAPITAL MANAGEMENT (2000); GARRY J. SCHINASI, SAFEGUARDING FINANCIAL STABILITY: THEORY AND PRACTICE, (2006); David Shirreff, *Lessons from the Collapse of Hedge Fund, Long-Term Capital Management*, The Institute of the Chief Risk Officers, http://riskinstitute.ch/146480.htm.

37. As initiated by the EU Commission with the Financial Services Action Plan. *See* The EU Single Market, *The Financial Services Action Plan* (1999), http://ec.europa.eu/internal_market/finances/actionplan/index_en.htm.

38. *See* THE REGULATION OF INTERNATIONAL FINANCIAL MARKETS: PERSPECTIVES FOR REFORM (Rainer Grote & Thilo Marauhn eds., 2006). Most of the contributions included in this book where delivered during a workshop which took place in 2001.

regulation of the banking industry, banking supervisors are principally interested in knowing whether the bank will have a problem reimbursing its depositors. Deposits are short-term liabilities while loans are long-term, illiquid bank assets. In addition, the provision of loans necessarily includes a certain degree of risk. Bank supervisors will verify that the risks are under control, that they are not too concentrated or provided to related parties. The interest rate must be consistent with the necessity for the bank to generate revenues to survive in the long-run. These preoccupations differ significantly from those of monetary policy makers whose first objective is to ascertain control over the flow of money held and generated by banks.

There is at least one situation where, as a matter of necessity, prudential regulators and the monetary policy makers need to act together—when they are embodied into separate institutions. This is when a bank has such severe liquidity difficulties that on the one hand there is a risk of a bank run,[39] and on the other hand there is a risk of definitive inability of the bank to reimburse its depositors. The central bank may in such a case offer a solution in its capacity as lender of last resort.[40] The prudential supervisor may take administrative measures (injunction, prohibition, administrative penalty, appointment of a provisional administrator, etc.) to limit the damages and, eventually, to put in place a rescue operation.

The significantly different angles of approach of the two

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39. Bank runs are a consequence of panics caused by a sudden—and often irrational—loss of confidence. The risk of bank runs, which is a consequence of panics, is currently significantly diminished by the existence of a deposit insurance scheme. The legitimacy of such a scheme in a market economy is indisputable, but it has to be properly framed to avoid 'free riders' and 'moral hazard.' *See* LASTRA, *supra* note 1, at 124-28.

40. Lastra provides an extremely clear description of the LOLR intervention going back to the still valid, first analyses of this problematic, by Thornton in 1802 and Bagehot in 1873, and the last developments with the amendments to the Federal Reserve Act in 1991, to require more accountability from Fed management when it decides to act as LOLR. In effect, at the end of the operation, if the bank is unable to reimburse the loan, (a part) of the burden of the insolvency will be born by the taxpayers. *See* LASTRA, *supra* note 1, at 113-20. On the LOLR problematic at the European level, see *id.* at 303-07; *see also* WHICH LENDER OF LAST RESORT FOR EUROPE? (C.A.E. Goodhart ed., 2000) (explaining that in a market economy, the burden of insolvency is borne by the creditors of the insolvent business).

authorities (monetary on the one hand, prudential[41] on the other hand) create diverging analysis and different actions. The Bank of Credit and Commerce International (BCCI) case offers a caution against giving the same person authority for prudential supervision and monetary functions.[42] The insolvency of a bank is always a risk for the reputation of the supervisor and is in practice unavoidable. As pointed out by Lastra, citing Charles Goodhart, "the conduct of supervision is a thankless task... [a] supervisor is only noticed when he/she angers the regulated by some restrictive or intrusive action, or when supervision fails in the sense that a financial institution collapses or a customer gets ripped off."[43]

On the other hand, in the case of separation of monetary and supervisory functions, there is no doubt that the absence of strong and efficient communication between the supervisor and the central bank may be the cause of significant malfunctioning of the global prudential system—whose fundamental purpose is financial stability. A remarkable institutional arrangement, on which Lastra insists, is the U.K. 'Standing Committee' which is intended

41. Prudential supervision' may be defined as the action by which the prudence of a person is assessed and controlled. It comprises surveillance of the existence of one's own sufficient funds to absorb eventual losses resulting from the risks taken in the business, the existence of an adequate organization, the fit and proper character of the management, the effectiveness of internal control mechanisms and of an internal audit department, and the compliance with codes of conduct in the relation of the bank with its clients, etc. The supervisory process implies transmittal of periodic accounting reports by the supervised entity to the supervisor, meetings to discuss attention points, and on-site inspections.

42. Notably, see Mads Andenas, *Liability for Supervisors and Depositors' Rights – The BCCI and the Bank of England in the House of Lords*, EUREDIA 2000/3 (commenting under the decision of the House of Lords, Three Rivers District Council v. Governor and Company of the Bank of England). The judgment of the House of Lords is available at http://www.publications.parliament.uk/pa/ld199900/ldjudgmt/jd000518/rivers-1.htm. As mentioned by Rosa Lastra, the case was abandoned on 2 November 2005, when BCCI liquidators dropped their claims (for an amount of £850 million) after receiving a legal ruling by the court supervising the liquidation that "it would not be in the best interest of BCCI's creditors to continue with the lawsuit." LASTRA, *supra* note 1, at 103 n.57. The Bank of England subsequently introduced a claim for the costs incurred in that lawsuit and eventually recovered more than £70 million by way of settlement with the liquidators. *See* BCCI Costs, Bank of England, June 7, 2006, http://www.bankofengland.co.uk/publications/news/2006/064.htm.

43. LASTRA, *supra* note 1, at 101.

to intervene before any lender of last resort operation or, more generally, in the case of a financial instability risk. This Committee includes representatives from the Central bank (Bank of England), the Treasury/Ministry of Finance, and the supervisory agency (Financial Services Authority).[44] Lastra considers that such a Committee should exist at the European level— the occurrence of a pan-European banking or financial crisis being less and less hypothetical with the progressive achievement of the internal market for financial services. She considers that in addition to these three parties, a representative of the competition directorate of the European Commission should also be present, since a rescue operation may imply injection of public money into a private business to possibly create an unfair competitive advantage.[45] In the EU, the second 'Brouwer report' has stressed the need to better coordinate financial crisis management at the EU level.[46]

Two other issues are presently contested in Europe: first, whether to establish a single regulatory authority for bank, insurance, and financial services; and second, whether the time is ripe to centralize prudential control in the hands of a single European supervisor. Lastra rightly points out that the empowerment of a single authority in Europe to exercise prudential supervision would require a Treaty change. Alternatively, to increase the power of the various advising institutions which were created in the wake of the Lamfalussy report[47] (Committee of European Securities Regulators for securities markets; Committee of European Banking Supervisors for credit institutions; and Committee of European Insurance and Occupational Pensions Supervisors for insurers and pension funds) in order to centralize prudential control under their leadership

44. *See* LASTRA, *supra* note 1, at 96, 314.

45. *Id.* at 311-15. As explained by Rosa Lastra, under EU regulation, even though the banking sector is specifically regulated—creating barriers to the entry and limitations to the free exercise of business—it is subject to competition regulation. *Id.* at 121-22.

46. *See* ECONOMIC AND FINANCIAL COMMITTEE, ECON. PAPER NO. 156, REPORT ON FINANCIAL CRISIS MANAGEMENT (2001), *available at* http://ec.europa.eu/economy_finance/publications/economic_papers/2001/ecp156en.pdf.

47. The Committee of Wise Men, Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (2001), *available at* http://ec.europa.eu/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf.

would probably not be easier to accomplish because increasing the power of these existing institutions would also require a new surrender of national sovereignty. Thus, even if the perpetuation of the present decentralized structure of prudential supervision in a monetary union and in an effective European single market is, intellectually, not satisfactory, it may be perfectly justifiable on an historical basis.

IV. MONETARY INSTITUTIONS, TRANSITION ECONOMIES, DEVELOPING COUNTRIES, AND POVERTY

In each part of her book, Lastra devotes one chapter, or several sections, to an analysis of the financial and monetary questions linked to development or transition economies. In part one, chapter five relates to "Monetary and Financial Law Reform in Emerging Economies" (151-170). In part two, a section relates to the European Union's 'Structural Funds' on behalf of less-developed regions of the EU (272-273). In part three, reflections on these themes come back at the end of each chapter.[48]

A lot has been written about "transition economies" and the manner in which they may find their way to becoming market economies. The least that can be said is that, for the time being, these economies have not enjoyed a pleasant route. They have had to swallow bitter medicine to approximate market economies and a democratic organization. Profound foundations have to be built on the sand of exhausted collective economies. But does anyone know what a well-organized market economy is? Does anyone know what a well-functioning democracy is? Is there anyone who can make a pure, 'ideology-free'

48. Citing the words of Henri Morgenthau at the opening of Bretton Woods in 1944: "Poverty, where it exists, is menacing to us all and undermines the well-being of each of us. It can no more be localized than war." LASTRA, *supra* note 1, at 370. Section H ("The Evolution of IMF Financial Facilities and Policies") of chapter thirteen ("The Law of the International Monetary Fund") is mainly dedicated to financial assistance for low-income countries. Section D of the last chapter (chapter fourteen: "International Financial Architecture") is dedicated to sovereign debt crisis and the role of the IMF as well as providing an interesting definition of an 'insolvent country': it is a country "that cannot pay its debts, not because it has insufficient assets but because it cannot mobilize the revenues required to service its debt without imposing great pain to its citizens, jeopardizing the survival of its government and impairing the social and political stability of the country itself." LASTRA, *supra* note 1, at 474.

presentation of the answers to these questions?

The most striking fact, from our Westerners' point of view, is the tenacity with which many intellectuals in the old collective economies work on the building of their societies—doing their best to employ the political, economic, financial, and monetary tools, and to put in place suitable regulations. Sometimes, they seem to have more rigor than we have. Other times, they seem to have more hope in the future than we have. But their environment too often presents a daily struggle against corruption, dependence, lack of experience, lack of competitiveness, and lack of legal foundations.

The IMF has invested substantial energy and expertise to assist the development, of solid monetary and financial foundations for 'transition economies', and closely follows their development as the numerous 'Article IV' reports published on the IMF website illustrate. The IMF often has the role of an educator (in the etymological meaning of the person who "makes grow outside the field of infancy").

Education is not in fashion nowadays, especially with the younger generation. The educator is suspected of oppression or abuse against ignorant subjects. He is suspected of trying to impose his unique way of thinking. It is in such a negative atmosphere that the so-called "Washington Consensus"[49] has been debated, mostly on Latin-American IMF 'conditional' financial assistance.

As pointed out by Lastra, the (short) history of IMF assistance to developing countries may be viewed as having experienced a pendulum move between current ideologies.[50]

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49. John Williamson coined the expression, without knowing that it would be the rallying cry of anti-globalization demonstrators. *See, e.g.*, John Williamson, Speech at the Center for Strategic & International Studies: Did the Washington Consensus Fail? (Nov. 6, 2002) (outline of speech available at http://www.iie.com/publications/papers/paper.cfm?researchid=488). The "Washington Consensus" is often associated with the neo-liberal agenda. *See, e.g.*, JOSEPH E. STIGLITZ, GLOBALIZATION AND ITS DISCONTENTS 74 (2002).

50. *See* LASTRA, *supra* note 1, at 156 (citing Jeswald W. Salacuse, *The Legal Architecture of Emerging Markets*, *in* THE REFORM OF THE INTERNATIONAL FINANCIAL ARCHITECTURE 48, 49 (Rosa Lastra ed., 2001).

The concept of 'Ideology' has a negative connotation as a consequence of a curious but nearly universal contamination by the Marxist use of the concept. This is the result of confusion, as the French philosopher Paul Ricoeur demonstrated, PAUL RICOEUR, LECTURES ON IDEOLOGY AND UTOPIA (1988), The history of IMF assistance to developing countries may be divided into three models. Between the 60s (decolonization) and the beginning of the 80s (the Thatcher-Reagan years), development was centered upon public ordering, reliance on public sector enterprises, and relatively closed economies ('Model 1'). Model 1 was disappointing in various ways, and a new model emerged ('Model 2') with four characteristics: (1) reliance on market forces, (2) privatization, (3) deregulation, and (4) openness to foreign investments. This Model is identified with the "Washington Consensus." The imperfections of this Model have made it unsatisfactory. Market forces left to themselves in developing countries tend to create sub-optimal equilibria. A 'Development Model 3' has not emerged, which seeks to combine in a subtle manner public and private intervention. Lastra explains, in a very convincing manner, the patient development that should unfold. First of all, an adequate legal framework must be put in place, which must be 'owned' by the country itself.[51]

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following the analysis of Clifford Geertz. *See* CLIFFORD GEERTZ, *Ideology as a Cultural System*, *in* THE INTERPRETATION OF CULTURES 193 (1973). Any action in the public sphere is unavoidably ideologically tainted, which means that behind the action, there is an engagement with the ideal organization of society as it can be symbolically designed. There is no doubt that the actions of the IMF has been, is, and will be ideologically oriented—i.e. that it will embody societal symbols shared by those who promote IMF action or, to speak in philosophical terms, IMF *praxis*. This does not mean that the IMF has been captured by one side against the other or, to take the words of the Soviet Finance Minister in 1947, that "the Bretton Woods Institutions were merely 'branches of Wall Street' . . . 'subordinated to political purposes which make it the instrument of one great power." LASTRA, *supra* note 1, at 354 n.38. The fact that IMF action is ideologically tainted only means that the IMF is not a natural object (see in that respect, the idea that monetary stability cannot be achieved by way of purely mechanical operation, *id.* at 53, where Rosa Lastra rightly writes that "[a]s a practical matter, politics has to play a role in the activities of central banks"). The IMF takes decisions, provides judgments, and proposes orientations which are not the pure product of abstract spirits but which are the result of the combination of expertise and judgment oriented towards what they think is the common good or, to be more accurate, which conforms to the purposes for which the IMF was created. As noted in Article I of the IMF's Articles of Agreement that provides the IMF objective: "to promote [] monetary cooperation," "balanced growth of international trade," "high levels of employment," "exchange rate stability," etc. *Id.* at 374.

51. *See* LASTRA, *supra* note 1, at 159. She comes back with the important concept of country "ownership" when she discusses the 'conditionality' of certain kinds of financial assistance granted by the IMF to its members, especially in developing countries. *Id.* at 412-27, 423. About the creation of regional groupings, which certainly offers one of the most interesting perspectives of

Concurrently, a strong administrative apparatus ('public institutions') must be built to regulate sensitive areas. On top of that, an efficient and independent judicial system must be created or reinforced. This entire system must be developed in the context of a market economy in-the-making, of course.

In any event, IMF assistance to developing countries is not a part of its core business. Theoretically, the IMF has only accessory competence in the field of development. Such a competency had initially been entrusted to the World Bank. As the "Meltzer Report"[52] implicitly pointed out, the tendency of public institutions is to broaden their area of activities rather than to narrow it (what the report calls "mission creep"), whatever the reason is for such a tendency.[53]

Henry Morgenthau, in the opening remarks at the 1944 Bretton Woods conference, declared that "Poverty, where it exists, is menacing to us all and undermines the well-being of each of us." Lastra, citing this declaration, considers that

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development for less developed countries, Rosa Lastra cites the twentieth-century Spanish philosopher, Ortega y Gasset, who stated that '"a nation is a unity forged in history, with a common destiny."' *Id.* at 205-06. She comments that:

> Though he had in mind the nation state, the idea of a 'common destiny' is a useful motto . . . to integration . . . . the single most important obstacle that developing countries face in their pursuit of effective integration is the lack of the necessary institutional and legal mechanisms to achieve the objectives of regional [] and monetary integration.

Id. at 206.

Lastra points out that countries which want to develop state-of-the-art legislation "need to understand that if it engages five sets of foreign advisors, they will propose five different laws, which will be inconsistent with each other and with the country's existing laws." In order to limit that hazard, "local draftsmen need to be closely involved in the drafting process." *Id.* at 165 n.42 (citing Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 847-49 (2001)).

52. *See* INTERNATIONAL FINANCIAL INSTITUTION ADVISORY COMMISSION REPORT (2000), *available at* http://www.house.gov/jec/imf/meltzer.htm. This report is cited once by Lastra. *See* LASTRA, *supra* note 1, at 418.

53. Be it because they have personal interests to be kept in charge of something rather than nothing or because they have the sentiment of a duty to do so in order to fill in a gap in the public area. An analytical approach would nonetheless disqualify any justification tainted with sentiments. This is, in my opinion, the most common mistake we are ideologically conditioned to do these days.

these words "still resonate" and "seem appropriate to describe the challenges that the IMF and the international community currently face and are likely to face in years to come."[54]

CONCLUSION

Lastra does not provide an 'economic analysis of law.' As she points out, not only has each discipline developed its own language, making it a more or less impenetrable bastion for experts or specialists, but also too many international institutions, in their admirable propensity to try to achieve their goals, have created a series of concepts that nobody other than their own servants understand.[55] Yet economics and law are inextricably linked in any approach to monetary questions. Lastra, as a lawyer, never loses her reader in the sometimes arcane language of legal specialists. One of the most striking results she achieves is to provide, in a succinct amount of pages (500), a clear picture of most of the monetary questions that are presently discussed. She exposes how a central bank should organize the safety–net resulting from its role as lender of last resort (LOLR) and how it must limit moral hazard. She explains the complex birth of the European Monetary Union (EMU) and the paradoxical situation of such a unique monetary Union within Europe which is still decentralized with regard to fiscal, prudential, and even most of its economic policies. She recalls with luminous details the miraculous reunification of Germany in 1990, upon a political decision of Chancellor Helmut Kohl against the will of the Bundesbank. She provides an extremely useful insight of the history, present multi-faceted activity, and perspectives of the IMF.

I have centered my review on some of these issues, treating them from a rather abstract perspective. Perhaps it is naïve, but I enjoyed reading the book because Lastra has manifested the will to share her deep understanding and her beliefs in the legal foundations of monetary stability which are probably, as stated at the beginning of this review, only at a preliminary stage of development.

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54. LASTRA, *supra* note 1, at 370.

55. About the IMF "clouds of specialized terminology," see *id.* at 385.

It is easier to write history long after the events. Lastra tells us a story which is in the making. In telling this story with the right words, she helps us understand what is happening, and helps us invest our trust in its proper achievement, in so far as an achievement may be awaited. As George Steiner stated in an interview: of course Jewish believers think that the Messiah will come, but some of them—who have a certain pleasure in living their life—hope that He will not come too soon, because once he arrives, the story will be achieved, which is not really what they want.[56]

There is no doubt that monetary stability, as well as financial stability, will remain challenging in the coming decades. There is no doubt that the institutions created sixty-years ago face significant criticism in that respect and have manifest weaknesses which will have to be cured in the coming years. There is no doubt that one of the most urgent cures is education—more people being made aware of the efforts which are being made to favor peace and prosperity in the world. I am of the opinion that with her latest book, Lastra provides a significant and academically impeccable contribution to that end.

56. *See* GEORGE STEINER & ANTOINE SPIRE, BARBARIE DE L'IGNORANCE (1999).